

DEPARTMENT OF STATE REVENUE
LETTER OF FINDINGS NUMBER 98-0201
GROSS INCOME TAX
For Tax Periods: 1993-March 24,1995

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Issues

1. Gross Income Tax: Payments from Joint Venture Partner

Authority: 45 IAC 1-1-58, IC 6-2.1-1-2.

Taxpayer disputes the imposition of tax on payments from its partner in a joint venture.

2. Gross Income Tax: Resource Recovery System Depreciation

Authority: IC 6-2.1-4-3, Auburn Foundry v. Tax Commissioners, 628 N.E. 2d 1260 (Ind. Tax 1994), IC 6-1.1-12-28.5 (b). IC 6-2.1-4-3, IC 6-8.1-5-1 (b).

Taxpayer protests the disallowance of the resource recovery system depreciation deduction.

3. Gross Income Tax: Gain On Accounts Receivable

Authority: Indiana Department of Revenue v. Felix, 571 N.E. 2d 287 (Ind. 1991), IC 6-2.1-2 (c)(1).

Taxpayer protests the assessment of gross income tax on the gain on accounts receivable.

4. Gross Income Tax: Enterprise Zone Apportionment

Authority: IC 6-2.1-3-32 (c), IC 6-2.1-3-32 (d).

Taxpayer disputes the calculation of the enterprise zone exemption.

5. Gross Income Tax: Income Received Pursuant to Memorandum of Understanding

Authority: 45 IAC 1-1-34.

Taxpayer disputes the imposition of gross income tax on income received pursuant to a Memorandum of Understanding.

6. Tax Administration: Penalty

Authority: IC 6-8.1-10-2 (a).

Taxpayer disputes the imposition of the negligence penalty.

Statement of Facts

Taxpayer is a holding company owning the stock of a manufacturer in Indiana. The manufacturer, which was formerly a division of a large corporation, has manufacturing facilities and performs research and development contracts for the federal government. After a routine audit, additional corporate income tax, penalty and interest were assessed for the tax years ending December 31, 1993 through March 24, 1995. Taxpayer timely protested this assessment. More facts will be provided as necessary.

1. Gross Income Tax: Payments from Joint Venture Partner

Discussion

Taxpayer entered into a joint venture with another corporation to provide engineering services for a research and development contract. The purchaser of the services from the joint venture always pays with two checks dividing the income with a check for fifty percent (50%) of the total amount going to each of the two partners. Periodically there is a reconciliation so that each partner receives income in proportion to the services they actually provided. The audit imposed income tax on the payments made by the other partner to Taxpayer to reconcile the accounts. Taxpayer contends that these payments are exempt from gross income tax as capital contributions to a partnership which are exempt pursuant to 45 IAC 1-1-58 as follows:

Contributions of capital to a corporation, joint venture or partnership are exempt from gross income tax. No gross receipts result to the recipient of the capital and none result to the donee upon his receipt of stock in exchange for the capital.

At hearing, Taxpayer's representatives discussed the reconciliation as payments to make the amounts commensurate with the work each partner actually provides for the contract. In some periods, one partner provides more work than the other. The services provided are very rarely equal in value. The checks are paid on a fifty-fifty basis as a convenience to the purchaser of the product. The reconciliation

appears to be to reconcile the income attributable to the services each partner actually provided during the payment period. Therefore the income is payment for services performed rather than a capital contribution. The regulation clearly refers to capital contributions in exchange for a share in the joint venture rather than receipts for services rendered. Therefore the payments received from the other partner in the joint venture do not qualify for exemption pursuant to 45 IAC 1-1-58.

Pursuant to IC 6-2.1-1-2 gross income "means all the gross receipts a taxpayer receives (1) from trades, businesses, or commerce;. . ." The income in this situation is clearly payment for engineering and other services provided by Taxpayer. As such, these receipts qualify for the imposition of gross income tax.

Finding

This point of Taxpayer's protest is denied.

2. Gross Income Tax: Resource Recovery System Exemption

Discussion

Taxpayer claimed a deduction on its gross income tax returns for the taxable years ending December 31, 1994 and March 24, 1995 for its resource recovery system. The auditor disallowed the deduction because Taxpayer could not produce an Indiana Department of Environmental Management certification of the system as a resource recovery system or other documentation associated with the deduction.

The denial of the deduction was based on Auburn Foundry v. Tax Commissioners, 628 N.E.2d 1260 (Ind. Tax 1994). That case concerned an Indiana business which attempted to deduct a resource recovery system from its property taxes. The approval of the property tax deduction rests upon the provisions of IC 6-1.1-12-28.5(b) as follows:

The department of environmental management, upon application by a property owner, shall determine whether a system or device qualifies for a deduction provided by section 28.5, 31,33, or 34 of this chapter. If the department determines that a system or device qualifies for a deduction, it shall certify the system or device and provide proof of the certification to the property owner.

The Auburn case concerns a deduction from property tax and specifically requires a certification from the Indiana Department of Environmental Management. The statute itself states that the certification requirement applies to applications for deduction pursuant to certain sections of the property tax law. It clearly does not apply to applications for deduction from gross income tax.

Taxpayer claimed the income tax resource recovery system deduction pursuant to the following provisions of IC 6-2.1-4-3:

If for federal income tax purposes a taxpayer is allowed a depreciation deduction for a particular taxable year with respect to a resource recovery system, and if the resource recovery system processes solid waste or hazardous waste, the taxpayer is entitled to a deduction from his gross income for the same taxable year.

The language of this statute does not require a certification by the Indiana Department of Environmental Management as a prerequisite to claiming a resource recovery system deduction. The fact that the property tax resource recovery system deduction requires a certification by the Indiana Department of Environmental Management does not mean that such a prerequisite can be inserted into the statute authorizing a gross income tax resource recovery system deduction. Taxpayer still bears the burden of proving, however, that it purchased a system which functioned as a resource recovery system and qualifies for a depreciation deduction from its federal income tax. IC 6-8.1-5-1 (b). Taxpayer failed to offer any evidence to substantiate that it bought such a system. Therefore, Taxpayer does not qualify for this exemption.

Finding

Taxpayer's protest of the denial of the resource recovery system deduction is denied.

3. Gross Income Tax: Gain On Accounts Receivable

Discussion

Taxpayer purchased another corporation. The acquisition resulted in a revaluation of certain assets, including accounts receivables. Subsequent receipts received in excess of basis were reported by Taxpayer as "other income" on its federal return. Audit proposed additional assessments of Indiana gross income tax on these amounts. Taxpayer protests these additional assessments.

The purchased corporation was an accrual taxpayer and paid the tax due on the sales represented by the accounts receivable prior to the transfer to the new owner, Taxpayer. Taxpayer argues that any additional tax would result in double taxation which the law must avoid pursuant to the findings in Indiana Department of State Revenue v. Felix, 571 N.E.2nd 287 (Ind. 1991). Taxpayer further argues that once the sale was complete and the receipts were realized and recognized, the repayment of the accounts receivables was a repayment of debt which is excluded from gross income pursuant to IC 6-2.1-1-2(c)(1).

In actuality a new entity, Taxpayer, received the income from the payment of the remainder of the monies owed on the accrual based accounts. Taxpayer, however, contends that this figure does not fairly represent the income since it was merely an arbitrary allocation of income. That does not change, however, the fact that Taxpayer specifically reported this income in this manner on its federal return.

This situation is analogous to the situation covered in 45 IAC 1-1-45 as follows:

When promissory notes, retail installment or conditional sales contracts are accepted as the basis under which payment is to be made, the full amount (except included insurance premiums or finance charges) of the intangible derived from selling, providing, repairing or servicing tangible personal property or derived from real property, less existing mortgages is taxable upon receipt of the note or contract. Moreover, income from the sale of such intangibles is also taxable to the extent that the tax has not been previously paid thereon.

The purchased corporation posted payment for these sales on an accrual basis. Thus, intangible assets, the accounts receivable, were created. Taxpayer then acquired these accounts receivable when it purchased the corporation. Audit is not attempting to tax the income from the sale of the intangible asset. Rather the audit imposes gross income tax on the income Taxpayer receives from the collection of the accounts receivable in excess of the basis. This is the income received from the intangible after the sale of the intangible. This is analogous to the taxable gross income subject to the gross income tax as discussed in 45 IAC 1-1-45.

Finding

Taxpayer's protest denied.

4. Gross Income Tax: Enterprise Zone Apportionment

Discussion

Taxpayer has claimed an exemption from their gross income tax returns for the taxable years ending December 31, 1994 and March 24, 1995 for a qualified increase in enterprise zone gross income. The exemption from gross income tax for a qualified increase in enterprise zone income is stated at IC 6-2.1-3-32. The exemption is equal to the amount by which gross income derived from sources within an enterprise zone exceeds the gross income derived from sources within an enterprise zone during a base period.

Taxpayer claimed the exemption for its Evansville facility. The facility was not in existence during the base period. Therefore all the qualified gross income received by the Evansville facility is exempt from the gross income tax. The issue is to determine the amount of the qualified gross income attributable to the Evansville facility for the taxable periods ending December 31, 1994 and March 24, 1995.

IC 6-2.1-3-32(c) defines "gross income derived from sources within an enterprise zone" as including the following elements.

- (1) gross income from real or tangible personal property located in an enterprise zone;
- (2) income from doing business in an enterprise zone;
- (3) income from a trade or profession conducted in an enterprise zone;

- (4) compensation for labor or services rendered within an enterprise zone; and
- (5) income from stocks, bonds, notes, bank deposits, patents, copyrights, secret processes and formulas, good will, trademarks, trade brands, franchises, and other intangible personal property having a situs in an enterprise zone.

Taxpayer's receipts from the Evansville facility qualify under this definition as income derived from the enterprise zone since its gross receipts derive from sale of products manufactured at the Evansville facility.

Taxpayer contends that these gross receipts do not fairly represent its business income from the Evansville facility. Rather, Taxpayer argues that it qualifies under IC 6-2.1-3-32 (d) to use an apportionment method to determine the income from the enterprise zone since the income derived from sources within the enterprise zone cannot be separated from the business income derived from sources outside the enterprise zone. Taxpayer argues that it cannot produce a profit and loss statement or net income statement from the Evansville facility books and records without including data from other facilities. Further Taxpayer argues that patents, trade brands and other intangibles with a business situs outside the Evansville facility produce income for the Evansville facility.

Taxpayer's arguments do not change the fact that the gross income tax is a gross receipts tax. Taxpayer's books clearly indicate the gross receipts attributable to its production of a product at the Evansville facility. The contention that Taxpayer cannot prepare a profit and loss or net income statement for the Evansville facility alone is irrelevant since this is a gross receipts tax, rather than a net receipts tax. Further, Taxpayer failed to show that any income from intangibles with a business situs outside of the Evansville facility affects the receipts from the Evansville facility in any way. Taxpayer's gross receipts from the Evansville facility can be separated from income derived from outside the enterprise zone.

Finding

This point of Taxpayer's protest is denied.

5. Gross Income Tax: Income Received Pursuant to Memorandum of Understanding

Discussion

Taxpayer received payments from another corporation pursuant to a Memorandum of Understanding. The Department imposed gross income tax on those receipts as taxable receipts pursuant to a contract which is separate and distinct from Taxpayer's original purchase agreement from the other corporation. Taxpayer contends that these receipts are in actuality a refund of a portion of the purchase price pursuant to the following provisions of 45 IAC 1-1-34:

Refunds are not subject to gross income tax in the hands of the recipient and are deductible from taxable gross receipts by the

payor if the amount of the refund was included by him in his total gross receipts.

The word "refund" includes amounts representing overpayments, the value of property returned to the seller, and adjustments by the seller to the selling price of property or services received either in cash or in the form of credits.

Taxpayer purchased its facilities, assets and business in an extremely large and complicated transaction. To be refunds, the payments would have to represent overpayments under the original contract. The receipts in question, however, were received in exchange for goods and or services pursuant to Memorandums of Understanding which constitute a subsequent contract. As such, these payments are not refunds exempt from the gross income tax. Rather the payments are income subject to the gross income tax.

Finding

Taxpayer's protest is denied.

6. Tax Administration: Penalty

Discussion

Taxpayer also protests the imposition of the negligence penalty pursuant to IC 6-8.1-10-2 (a), which states as follows:

If a person fails to . . . pay the full amount of tax shown on his return on or before the due date for the return or payment, incurs, upon examination by the department, a deficiency which is due to negligence, . . . the person is subject to a penalty.

Evidence indicates that Taxpayer failed to establish a system to insure the reporting of all its gross receipts. The breach of the duty to properly report gross receipts constitutes negligence.

Finding

Taxpayer's protest is denied.